No. 15,600

In the United States Court of Appeals for the Ninth Circuit

BETTY FINNEY AND EDWARD F. FINNEY, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

On Petition for Review of the Decisions of the Tax Court of the United States

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 30-47)[1] are not officially reported.

JURISDICTION

This petition for review (R. 50-61) involves federal income taxes for the taxable year 1945. On August 18, 1953, the Commissioner of Internal Revenue

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[1] By order of this Court entered June 28, 1957 (R. 70), the taxpayers were permitted to submmit this case on a typewritten transcript of the record and typewritten briefs. Accordingly, all record references herein are to the typewritten transcript of record on appeal. The typewritten copy of the record furnished to counsel for the Commissioner seems to contain many typographical errors, particularly in the taxpayer's testimony (R. 83-199), but we find none which seem to seriously alter the import of the taxpayer's testimony.

mailed to Mrs. Betty Finney and Edward F. Finney (herein referred to as the taxpayer)[2] statutory notices of deficiency asserting certain income tax deficiencies against them for the years 1944 and 1945. (R. 6-12, 20-26.) Within ninety days thereafter, and on October 12, 1953, the taxpayer and his wife filed separate petitions with the Tax Court for a redetermination of such deficiencies under the provisions of Section 272 of the Internal Revenue Code of 1939. (R. 1-5, 15-19.) The cases were consolidated before the Tax Court for opinion and decision (R. 73), and the decisions of the Tax Court affirming the Commissioner's determination in part (R. 48, 49) were entered January 16, 1957. The case is brought to this Court by a petition for review (R. 50-61) filed April 3, 1957. Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTIONS PRESENTED

1. Whether the taxpayer has met his burden of proving that he sustained a deductible loss under Section 23(e) of the Internal Revenue Code of 1939, in 1945 in connection with his investment in the motion picture "Strange Holiday".

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[2] The petitioners are husband and wife, residents of Los Angeles, California, who filed their separate income tax returns for the years involved on the community property basis with the Collector of Internal Revenue for the Sixth District of California, at Los Angeles. (R. 32-33.) The adjustments to income here involved relate to the income and deductions of the husband which were reported on their separate returns.

2. Whether the taxpayer has met his burden of proving that he sustained a deductible loss under Section 23(e) of the Internal Revenue Code of 1939, in 1945 in connection with his investment in the motion picture "White Fury".

3. Whether sums received by the taxpayer in the year 1945 from the motion picture production "Sensations of 1945" constituted ordinary income or long term capital gain.[3]

STATUTE INVOLVED

Internal Revenue Code of 1939:

> SEC. 22. GROSS INCOME.
>
> (a) [As amended by Sec. 1 of the Public Salary Tax Act of 1939, c. 59, 53 Stat. 574] *General Definition.* — "Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce,

[3] The proceeding before the Tax Court also involved the questions: (1) whether sums received in 1944 and 1945 from the motion picture production "Hi Diddle Diddle" constituted ordinary income or long term capital gain; and (2) whether for the year 1945 the taxpayer and his wife were entitled to the statutory standard deduction from income as well as the itemized deductions claimed on their returns. On brief, after the hearing, the Commissioner conceded both of these issues and the original deficiencies determined by the Commissioner were reduced by th Tax Court accordingly, eliminating the deficiencies for 1944.

or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * *

(26 U.S.C. 1952 ed., Sec. 22.)

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * *

(26 U.S.C. 1952 ed., Sec. 23.)

STATEMENT

The taxpayer has been engaged in various phases of the motion picture industry, including the production, direction, purchases and sales of motion pictures. (R. 33.)

1. In 1943 the taxpayer purchased a motion picture entitled "Strange Holiday" from a major studio. This picture starred Claude Rains, and dealt with an imaginary invasion and occupation of the United

States by the forces of Nazi Germany. It had originally been produced by an industrial corporation at a cost of approximately $200,000, for exhibition to employees. It was then sold to the studio for approximately $50,000. (R. 33.)

The purchase price paid by the taxpayer was $4,000. In addition, changes were made to adapt the picture for commercial exhibition, at a cost of $6,300, making a total outlay in the amount of $10,600. Expenditures continued until at least some time in August of 1945. (R. 33.)

In 1945 the taxpayer was unsuccessful in attempts to distribute "Strange Holiday" for exhibition. Thereafter, he kept the picture in storage but without payment of storage fees, and made constant but non-intensive efforts to sell or distribute it. In 1951 it was sold for approximately $2,100. The purchaser thereafter expended approximately $20,000 in activities preliminary to exhibition, and did in fact exhibit "Strange Holiday". (R. 33-34.)

In their 1945 returns, the taxpayer and his wife each deducted one-half of the total amount representing costs and expenditures incurred by the taxpayer in respect of "Strange Holiday", on the theory that it had become worthless in 1945. The Commissioner disallowed such deductions, on the theory that such worthlessness in that year had not been established. (R. 34.)

2. In 1943 the taxpayer and A. W. Hackel purchased for $3,000 distribution rights, copyrights and various other rights to a motion picture produced in Sweden, purportedly owned by a Swedish corpora-

tion known as Irefilm, and entitled "White Fury". In 1943 $500 was paid and the balance of $2,500 on September 21, 1945. These payments were made to an individual who had produced and directed that film, and who represented himself as fully authorized to sell it. (R. 34.)

The taxpayer paid the $3,000 required by the terms of the sale and also incurred expenses in the amount of $7,000 in readapting "White Fury", or a total outlay in the amount of $10,000. Changes and readaptation began in 1943 and ended in the summer of 1945. A first screening took place in September or October of 1945. (R. 34.)

After the screening a representative of a Swedish business organization denominated A. B. Sandrew-Ateljeerna contacted the taxpayer. He alleged that Irefilm had become a bankrupt in 1939, that his principal owned all rights to "White Fury", and that the person who had purported to sell the film had no authority to do so. A series of correspondence and telephone conversations then commenced. An offer by the Swedish firm to permit the taxpayer, for $10,000 to hold and exercise the rights purportedly transferred to him was rejected. (R. 34-35.)

While these communications were taking place the taxpayer sent the negative of "White Fury" to his agent in England to attempt to sell English rights in it. On December 3, 1945, an attorney representing the Swedish firm wrote to that agent, informing him of the existing situation, and alleging that the taxpayer had no rights in the film. A series of cor-

respondence then commenced between the agent and the representatives of the Swedish firm. (R. 35.)

At no time during 1945 did the taxpayer admit by word or deed the correctness of any claims adverse to his purported interest in "White Fury". When a seizure of the negative in the agent's possession was threatened, the taxpayer instructed his agent to resist such action. However, sometime in 1946 an injunction was secured and the negative seized. (R. 35.)

Thereafter, the taxpayer made only minor efforts to determine the liability of the person to whom the $3,000 had been paid. No effort was made to collect any part of that amount. His investigation went no further than a general observation of the dwelling and automobile of that person, an inquiry of a mutual friend, which disclosed that the individual involved was a veteran of World War II and had recently married, and an oral statement by the seller that he did not have any money. (R. 35-36.)

On their 1945 returns the taxpayer and his wife each deducted one-half of the total amount representing costs and expenditures by the taxpayer in respect of "White Fury", on the theory that the taxpayer's interest therein had become worthless in 1945. The Commissioner disallowed that deduction, on the theory that such worthlessness in that year had not been established. (R. 36.)

3. In 1942 the taxpayer learned that Andrew Stone planned to produce a series of motion pictures through a corporation to be organized. He joined in this enterprise, and Andrew Stone Productions,

Inc. (hereinafter called "Productions"), was formed on September 16, 1942. The taxpayer lent Productions $20,000, payable out of profits only, with interest at six per cent per annum. No note or other evidence of indebtedness was issued. However, because of the loan the taxpayer was permitted to purchase for $20 twenty shares of common stock. As of January 8, 1943, total capital stock outstanding consisted of 100 shares held as follows (R. 36):

Shareholder	No. of Shares
Andrew Stone	60
Frederick Jackson	20
Edward Finney	20

Productions was financed by loans from banks and others. At the time of its formation it and the three stockholders entered into agreements respecting various matters, including services to be rendered by and salaries to be paid to each. The agreements respecting services and salaries were particularly pertinent to a motion picture entitled "Hi Diddle Diddle", subsequently produced by Productions. At least three such written agreements were executed on, respectively, December 31, 1942, March 10, 1943, and August 6, 1943. (R. 36-37.)

The three stockholders became officers, directors and employees. The taxpayer was employed as associate producer for "Hi Diddle Diddle". He assisted in obtaining financing, organized the production staff, helped cast part of the picture, engaged the office staff, and handled diverse other business matters. Jackson wrote the screen play, and Stone was employed as producer-director. The salary payable

to the taxpayer for his services in the production of "Hi Diddle Diddle" was $12,000. That of Jackson and Stone was, respectively, $20,000 and $60,000. A substantial part of each of the foregoing salaries was deferred pursuant to written agreement. Production of "Hi Diddle Diddle" commenced in March of 1943, and the film was released in August of the same year. (R. 37.)

Shortly after Productions commenced activity persistent disagreements arose between the taxpayer and Stone. Attempts at reconciliation failed, until a written agreement was entered into dated September 23, 1943. Both parties were represented by counsel, and dealt at arm's length. (R. 37.)

At the time of the foregoing agreement the taxpayer had received neither interest nor principal on his loan, and $9,000 remained unpaid of his salary for "Hi Diddle Diddle". The only asset then owned by Productions, aside from an insubstantial amount of cash, was that film. It was subject to substantial liabilities, but an agreement with United Artists provided for its distribution and exhibition. (R. 38.)

The settlement of September 23 was in the form of a letter addressed to Productions, Jackson and Stone, and signed by the taxpayer, Jackson and Stone, and, in turn, approved on behalf of Productions by its president and secretary. It read in part as follows (R. 38-40):

> This will confirm our understanding that all previous agreements heretofore entered into between us including but not limited to those agreements dated as of December 31, 1942,

March 10, 1943, and August 6, 1943, are rescinded and cancelled and in addition to the salary of $12,000 for my services rendered in connection with the production of the motion picture photoplay Hi-Diddle-Diddle of which sum I have heretofore received $3,000 and the remainder of $9,000 is to be paid to me concurrently with salary payments yet to be made to Andrew L. Stone and Frederick Jackson as negative costs of Hi-Diddle-Diddle, are recouped, I hereby agree to sell to you or your nominees all capital stock now held by me in Andrew Stone Productions, Inc., for the following consideration, to-wit:

(a) In addition to the sum of $9,000 cash to be paid me from recoupment of the negative costs of Hi-Diddle-Diddle (constituting deferred salary and hereinabove referred to) I am to receive $5,000 in cash within three weeks of the commencement of the principal photography upon the next picture to be produced by Andrew Stone together with the deferred payment of $2,500.00 payable within two years from the release date of said picture and in addition thereto I am to receive a cash payment of $5,000 within three weeks from the commencement of principal photography upon the second motion picture yet to be produced by Andrew Stone, and an additional cash payment of $6.000 within three weeks from the commencement of principal photography upon the third picture yet to be produced by Andrew Stone for release by United Artists under the existing distribution agreement or any extension, renewal, replacement or substitution thereof.

(b) In addition to the cash payments herein-

above specified I am to receive directly from United Artists as distributor of Hi-Diddle-Diddle, 20% of the producer's net profits receivable by producer from the production and/or distribution of Hi-Diddle-Diddle and 12% of the producer's net profits receivable by producer from the production and/or distribution of each of the next three motion pictures produced by Andrew Stone for release by United Artists under the existing distribution agreement or any extension, renewal, replacement or substitution thereof. * * *

"Producer's net profits" are defined in the agreement as receipts less certain specified costs and expenses and all taxes. However, deductions for salaries to Jackson and Stone were limited for the purpose of computing "producer's net profits". (R. 40.)

The agreement further provided in part as follows (R. 40-41):

2. I consent to the pledge of my share of the residual values in Hi-Diddle-Diddle upon the same basis only as the pledge of all other residual shares as security for financing necessary to production of the second picture to be produced by Andrew Stone and I furthermore consent to the pledge of my share of the residual values upon the second picture yet to be produced by Andrew Stone for financing necessary to production of the third picture to be produced by Andrew Stone, upon the same basis as the pledge of all other residual shares, and I furthermore consent to the pledge of my share of the residual values in the third picture to be produced by Andrew Stone upon the same basis as all other residual shares, if it is necessary to

pledge the same to secure financing to produce the fourth picture to be produced by Andrew Stone; * * *

* * * *

4. It is expressly understood that I shall not be obligated to render services of any nature whatsoever in the future and shall not be deemed to be an agent, partner, representative, associate or affiliate of yourself or any of the producing companies hereafter concerned with the production of said three motion pictures yet to be delivered to United Artists, and I shall be held free and harmless of and from all personal liability whatsoever in connection with the production and/or distribution of each of said pictures.

5. The aggregate sum of $20,000 invested by me in Hi-Diddle-Diddle shall be repaid from the recoupment of negative costs upon said motion picture together with interest at 6% from the dates of each advance made by me as soon as the prior liens of the banks, Standard Capital, DeLuxe Laboratories, and General Service Studios upon said motion pictures have been discharged, which sum of $20,000 may be paid directly for my benefit and on my account to the Bank of America National Trust & Savings Association as provided in that certain agreement executed with Standard Capital Co. dated March 18, 1943.

The agreement also provided that the taxpayer would be credited as "associate producer", contained a general release by the taxpayer, and specified that it constituted the compromise of a controversy. It specifically limited the taxpayer's rights to the next three pictures to be produced after "Hi Diddle

Diddle" for distribution through United Artists. The foregoing payments were due only if such pictures should be produced. The taxpayer could not affirmatively require the production of any pictures. (R. 41-42.)

Sometime in 1943, after the foregoing agreement of September 23, Productions was liquidated and dissolved. Thereafter, Stone and Jackson produced a motion picture entitled "Sensations of 1945" through a corporation in which the taxpayer had no interest but which apparently inherited Productions' liabilities under the agreement of September 23. The taxpayer was entitled, inter alia, to 12 per cent of the "producer's net profits" on "Sensations of 1945". For reasons which represented arm's length considerations, he consented to the reduction of the share to 10.8 per cent. (R. 42.)

On the basis of the evidentiary facts found as restated above, the Tax Court found as ultimate facts that "Strange Holiday" and "White Fury" did not become worthless in 1945 and the taxpayer may not deduct as losses in that year the amounts of his investment therein; and further that the amounts received by the taxpayer on account of "Sensations of 1945" are not proceeds from the sale or exchange of capital assets, but are taxable as ordinary income. (R. 42-43.)

SUMMARY OF ARGUMENT

Deductions from income for federal income tax purposes are allowed only as a matter of legislative grace. Statutes authorizing such deductions are to

be strictly construed, and the burden is upon the taxpayer claiming a deduction to bring himself squarely within the provisions of the statute. In this case the taxpayers are claiming deductions under those provisions authorizing deductions for "losses sustained during the taxable year and not compensated for by insurance or otherwise" if incurred in trade or business or in a transaction entered into for profit, though not connected with the trade or business. Such deductions are allowable only for the year in which they are *sustained.* Here loss deductions were claimed on account of the alleged worthlessness of two motion pictures in the year 1945. The Commissioner determined that the alleged losses were not sustained in the year 1945 as claimed, and the burden was upon the taxpayer to prove the fact that the two motion pictures became worthless in that year.

The evidence relied upon by the taxpayer to meet his burden of proof consists almost entirely of the uncorroborated testimony of the taxpayer himself. It is vague and unconvincing. As to one picture, "Strange Holiday", alleged to have become worthless in 1945, the testimony shows only that considerable expenditures had been made, some as late as August, 1945, to adapt the picture for commercial exhibition, but that the taxpayer was unsuccessful in his efforts during the remainder of the year to get the picture exhibited commercially. Although contending that the film became valueless in 1945 he kept it, continuing his efforts, although apparently not very aggressively, to dispose of it or get it exhibited until

he sold it in 1951 for about $2,100. The evidence, such as it is, fails to show that the picture became worthless in 1945. As to the other picture, "White Fury", the record is equally vague and unconvincing. Rights to the film ostensibly were acquired by the taxpayer upon payment of $3,000 to an individual who allegedly was not authorized to sell it. After expending additional sums to adapt the film for exhibition the taxpayer was advised in 1945 of adverse claims to the film, and actively resisted such claims until the negative was seized by court order some time in 1946 in England. The taxpayer made no serious attempt to ascertain the liability of the individual from whom he had purportedly acquired rights in the picture, and apparently completely dropped the matter after the negative had been seized. The evidence does not warrant a finding that he sustained a deductible loss in 1945, however.

The evidence does not support the taxpayer's contention that payments received under the agreement of September 23, 1943, representing his share of "producer's net profits" from the motion picture "Sensations of 1945" constituted capital gains. The agreement was entered into to compromise and settle personal differences which had arisen between the taxpayer and Stone, president and majority stockholder of Andrew Stone Productions, Inc. It provided, among other things, in addition to the sale of the taxpayer's stock in Productions, for the cancellation of all existing agreements between the parties, mutual release of all claims and demands against each other, payment of deferred salary owing the

taxpayer and money advanced to the corporation by the taxpayer, division of the profits of a motion picture just produced and of not more than three motion pictures to be produced in the future, if and when produced, pledge of residual value of completed pictures for financing future pictures, etc. The amounts here in issue, being payments under the agreement in connection with a picture subsequently produced, do not represent payments on the sale of the taxpayer's stock in Productions but represent payments received in connection with other matters dealt with in the agreement of September 23, 1943, and are taxable as ordinary income.

The taxpayer's present contention that in addition to his Productions stock he also sold his interest in a partnership, which was a capital asset, is without evidentiary foundation and without merit. Likewise, taxpayer's argument, based on an obviously inadvertent inconsistency between one of the Tax Court's findings and its opinion and decision, is without merit, and the record as a whole fails to show error on the part of the Tax Court in finding and holding that the amounts in issue are taxable as ordinary income.

ARGUMENT

I

The Taxpayer Has Failed To Prove That He Sustained Deductible Losses In 1945 In Connection With His Investments In the Motion Pictures "Strange Holiday" and "White Fury"

In their separate income tax returns for the year 1945 the taxpayer and his wife claimed losses on

motion pictures in the amount of $10,300, consisting of a claimed loss of $5,300 on the motion picture "Strange Holiday" and a claimed loss of $5,000 on the motion picture "White Fury", one-half of the claimed losses being deducted on each return. The Commissioner determined that no deductible loss was sustained during the year on account of these pictures and disallowed the deductions in determining the deficiencies here involved. (R. 10-11, 24-25.) It was stipulated in the Tax Court (R. 29) that the total sums spent by the taxpayers for "Strange Holiday" and "White Fury" were $5,300 and $5,000, respectively, so the amounts involved are not in issue.[4]

The facts, as best they can be gleaned from the evidence, with respect to the taxpayer's acquisition of these motion pictures, his efforts to exploit them for profit, and their ultimate disposition, are set out in the Tax Court's findings (R. 32-36) and in the foregoing statement. In its opinion the Tax Court concluded (R. 43-46), and we submit properly so, that the taxpayer had failed to prove that he had sustained a loss in 1945 in connection with his investment in either of these motion pictures.

It has long been settled that deductions from gross income are allowed for federal income tax purposes

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[4] These stipulated figures do not seem to be reconcilable with the findings of the Tax Court (R. 33, 34) that the taxpayer's total outlay for "Strange Holiday" was $10,600 and for "White Fury" was $10,000—exactly twice as much in each instance—but they correspond with the loss deductions disallowed by the Commissioner (R. 10-11, 24-25). This matter is not important to a determination of the issues here involved, however.

only as a matter of legislative grace, that statutory provisions authorizing deductions from income are to be strictly construed, and the burden is upon the taxpayer claiming a deduction to bring himself clearly within the provisions of the statute.[5] In this case the deductions in issue are claimed under Section 23(e) of the Internal Revenue Code of 1939, *supra*, which provides, among other things, that in computing net income there shall be allowed as deductions, in the case of an individual, "losses sustained during the taxable year and not compensated for by insurance or otherwise", if incurred in trade or business or if incurred in a transaction entered into for profit, though not connected with the trade or business.

Losses are deductible under this section only for the year in which they are *sustained*, and the burden of proving that a loss occurred during the year for which a deduction is claimed is upon the taxpayer. *Boehm* v. *Commissioner*, 326 U.S. 287, 292-293; *Jones* v. *Commissioner*, 103 F. 2d 681, 684 (C.A. 9th), and cases cited. And where, as here, the claimed loss is based on alleged worthlessness of property, the burden is upon the taxpayer to show definitely that the property became worthless during the taxable year.[6]

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[5] *New Colonial Co.* v. *Helvering*, 292 U.S. 435, 440; *Deputy* v. *du Pont*, 308 U.S. 488, 493; *Helvering* v. *Northwest Steel Mills*, 311 U.S. 46, 49.

[6] See *DeLoss* v. *Commissioner*, 28 F. 2d 803 (C.A. 2d), certiorari denied, 279 U.S. 840; *Gowen* v. *Commissioner*, 65 F. 2d 923 (C.A. 6th), certiorari denied, 290 U.S. 687; *Cass* v. *Helvering*, 83 F.2d 841 (C.A. 8th); *Brown* v. *Commis-*

The Tax Court having found that the taxpayer failed to prove worthlessness in 1945, the following statement of the Supreme Court in *Boehm* v. *Commissioner*, 326 U.S. 287, 293, is peculiarly applicable here:

> But the question of whether particular corporate stock did or did not become worthless during a given taxable year is purely a question of fact to be determined in the first instance by the Tax Court, the basic fact-finding and inference-making body. The circumstance that the facts in a particular case may be stipulated or undisputed does not make this issue any less factual in nature. The Tax Court is entitled to draw whatever inferences and conclusions it deems reasonable from such facts. And an appellate court is limited, under familiar doctrines, to a consideration of whether the decision of the Tax Court is "in accordance with law." 26 U.S.C. § 1141(c)(1). If it is in accordance, it is immaterial that different inferences and conclusions might fairly be drawn from the undisputed facts. *Commissioner* v. *Scottish American Co.*, 323 U.S. 119.

The taxpayer was not represented by counsel at the hearing before the Tax Court, and his testimony

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sioner, 94 F. 2d 101 (C.A. 6th); *Schmidlapp* v. *Commissioner*, 96 F. 2d 680 (C.A. 2d); *Jones* v. *Commissioner*, 103 F. 2d 681 (C.A. 9th); *Hadley Falls Trust Co.* v. *United States*, 110 F. 2d 887 (C.A. 1st); *Morton* v. *Commissioner*, 112 F. 2d 320 (C.A. 7th); *Bartlett* v. *Commissioner*, 114 F. 2d 634 (C.A. 4th); *Nelson* v. *United States*, 131 F. 2d 301 (C.A. 8th); *Rand* v. *Helvering*, 116 F. 2d 929, 933 (C.A. 8th), certiorari denied, 313 U.S. 594; *Green* v. *Commissioner*, 133 F. 2d 76 (C.A. 10th).

is understandably vague. Furthermore, the evidence consists almost entirely of the uncorroborated testimony of the taxpayer himself. It is clear from the transcript of the hearing, however (R. 75-200), that both the presiding Judge and counsel for the Commissioner assisted the taxpayer to the best of their ability in an effort to get a clear understanding of the facts. Despite this, however, the evidence does not warrant a finding that the taxpayer sustained losses as alleged with respect to his investment in the motion pictures "Strange Holiday" and "White Fury".

1. The taxpayer purchased the motion picture "Strange Holiday" from a major studio in 1943 at a cost of $4,000. The film originally had been produced by General Motors Corporation, apparently after World War II started, at a cost of $200,000, for exhibition to its employees. The picture starred Claude Rains, and dealt with an imaginary invasion and occupation of the United States by the forces of Nazi Germany. After the film had served its purpose the company sold it to a major studio for $50,000, from which it was acquired by the taxpayer for $4,000. The taxpayer had certain changes made in the film to adapt it for commercial exhibition, at a cost of $6,300, making a total outlay in the amount of $10,600.[7] These expenditures continued until at least some time in August, 1945.

The taxpayer was unsuccessful in his efforts to distribute "Strange Holiday" for exhibition. Ac-

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[7] See fn. 4, *supra*.

cording to his testimony (R. 83-99, 118-132) he apparently made no serious efforts to this end after 1945, merely keeping the film stored at a processing laboratory, without cost, until it was sold in 1951 for about $2,100.

Taxpayer's principal contention (Br. 34-41) seems to be that because of the nature and theme of the picture it becomes worthless upon the cessation of hostilities between this country and Germany in the spring of 1945. The taxpayer did not specifically so testify, and there is no direct evidence of that fact in the record. The only evidence, in fact, as stated above, is the taxpayer's own vague self serving testimony. This consists mostly of his testimony concerning efforts to get the picture exhibited and uncorroborated statements of other individuals, all equally vague, which he sought to bring out at the hearing. He testified that his accountant charged the cost of the film off on his books as a loss at some indefinite time in 1945, but no books were produced to corroborate that testimony. If the value of the picture depended upon the public mood, as taxpayer seems to contend, that fact may well have been reflected in the low price for which he acquired it. The record fails to disclose that the film had any greater or less value at the beginning of 1945 than it did at the end of 1945, and since it starred Claude Rains the record indicates that the taxpayer still expected to realize something from his investment.

It seems quite clear from the taxpayer's testimony that he did not abandon the film in 1945, or at any other time prior to the time he sold it in 1951 for

$2,100. And while his testimony seems to minimize his interest in the film after 1945 it also indicates that he had a continuing intention to exploit it for profit if he could. The fact that he sold it for $2,100 in 1951 leaves little merit to his contention that it became valueless in 1945. Not only that, but the purchasers had confidence enough in the film to spend some $20,000 on it with the idea of making it a commercial success.

As did the Tax Court (R. 43), we have carefully reviewed the entire record in this case, and we respectfully submit the Tax Court did not err in concluding that the taxpayer did not prove that he sustained a loss in 1945 on account of the motion picture "Strange Holiday" having become worthless in that year.

2. What has been said above with respect to the taxpayer's claim of a loss deduction on account of the alleged worthlessness of the motion picture "Strange Holiday" applies as well to his claim of a loss deduction on account of the alleged worthlessness of the motion picture "White Fury". Only the facts differ somewhat. The Tax Court found (R. 34) that in 1943 the taxpayer and another purchased for $3,000 distribution rights, copyrights, and various other rights to "White Fury", a motion picture produced in Sweden and purportedly owned by a Swedish corporation known as Irefilm. A payment of $500 was made in 1943 and the balance of $2,500 was paid on September 21, 1945, these payments having been made to an individual who had produced and

directed the film and who represented himself as fully authorized to sell it.

In addition to the $3,000 required by the terms of the sale, the Tax Court found that the taxpayer also incurred expenses in the amount of $7,000, making a total outlay of $10,000,[8] in readapting the film for American distribution. These changes and readaptations began in 1943 and ended in the summer of 1945, and a first screening took place in September or October of 1945. After the first screening, a representative of a Swedish business organization denominated A. B. Sandrew-Ataljeerna contacted the taxpayer and claimed that Irefilm had become bankrupt in 1939, that his principal owned all the rights to "White Fury", and that the person who had purported to sell the film to the taxpayer had no authority to do so. A series of correspondence and telephone conversations then ensued, and an offer by the Swedish film to permit the taxpayer for $10,000 to hold and exercise the rights purportedly transferred to him was rejected. In the meantime, the taxpayer had sent the negative of "White Fury" to England to attempt to sell English rights in it. On December 3, 1945, an attorney representing the Swedish film wrote to that agent, informing him of the existing situation, and alleging that the taxpayer had no rights in the film. A series of correspondence then followed between the agent and the representative of the Swedish firm. (R. 34-35.)

At no time during 1945 did the taxpayer admit by

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[8] See fn. 4, *supra*.

word or deed the correctness of any claims adverse to his purported interest in "White Fury". When a seizure of the negative in the agent's possession was threatened, the taxpayer instructed his agent to resist such action. However, sometime in 1946 an injunction was secured and the negative was seized. Thereafter, the taxpayer made only minor efforts to determine the liability of the person to whom the $3,000 had been paid and no effort was made to collect any part of that amount. The taxpayer's investigation went no further than a general observation of the dwelling and automobile of that person, an inquiry of a mutual friend which disclosed that the individual involved was a veteran of World War II, and an oral statement of the seller that he did not have any money. (R. 35-36.)

The substance of the taxpayer's argument (Br. 41-47) seems to be that by the end of 1945 he realized he had made a foolish investment in buying "White Fury" and was willing to forget the whole matter, and therefore should be allowed to deduct the resultant loss. But the taxpayer's own testimony with respect to this issue (R. 99-108, 132-143, 150-151), does not support his claim that the loss was *sustained* in 1945. That testimony, like the rest of his testimony, is self serving and understandingly vague, is entirely uncorroborated, and definitely does not establish that he sustained an actual loss of his investment in 1945. Many of the cases cited above clearly show that the evidence relied upon here is not sufficient to prove that a loss was sustained in 1945 as claimed. This Court's opinion in *Jones* v. *Com-*

missioner, 103 F. 2d 681, seems particularly apropos here, but most especially the following statement (p. 685):

> It is extremely uncertain, it is true, from the evidence produced by the taxpayer and, perhaps, from the findings of the Board [now the Tax Court], whether anything at all would ever be realized from the Securities Company stock. We are not, however, positive that it became absolutely worthless in 1933, or that it had a less value in 1933 than in 1932, or, for that matter, a greater value, or that 1934 was not the year, or, even, 1935. No showing has been made sufficient to justify us in ignoring the presumption of correctness in the Commissioner's ruling, or to hold there was an entire lack of substantial evidence to support the findings of the Board. Moreover, if there is opportunity for opposing inferences, the judgment of the Board controls. [Citations.]
>
> While it is also quite true "that a loss may become complete enough for deduction without the taxpayer's establishing that there is no possibility of an eventual recoupment.", and that "The taxing act does not require the taxpayer to be an incorrigible optimist." [Citations], nevertheless, cessation of business is not conclusive, though, of course, not every possibility of value will be considered. [Citation.] A real loss is sustained only when all chances or possibilities of collection have been effectively destroyed. [Citations.]

We submit that in the instant case all chances or possibilities of the taxpayer recovering his investment in "White Fury" had not been effectively destroyed

by the end of 1945 and that accordingly the Tax Court did not err in sustaining the Commissioner's disallowance of the claimed deduction on account of "White Fury" becoming worthlessness in that year.

II

The Tax Court Clearly Did Not Err In Holding That Sums Received By the Taxpayer In 1945 From the Motion Picture Production "Sensations of 1945" Constituted Ordinary Income Rather Than Capital Gain

In 1942 the taxpayer joined with Andrew Stone and Frederick Jackson to form Andrew Stone Productions, Inc. (herein called Productions), incorporated under the laws of California on September 16, 1942, to produce a series of motion pictures, with the taxpayer and Jackson each owning a 20% stock interest (represented by 20 shares each) and Stone owning a 60% stock interest (represented by 60 shares), all three becoming officers, directors and employees. The evidence does not show what Stone or Jackson paid for their stock, but the taxpayer paid $20 for his 20 shares and loaned Productions $20,000, repayable out of profits only, with interest at 6% per annum, no note or evidence of indebtedness being issued therefor. In addition to this loan, Productions was financed by loans from banks and others.

At and after the time Productions was formed, it and its three stockholder-officers entered into agreements, none of which were introduced in evidence, respecting various matters, including services to be rendered by and salaries to be paid to each. The agreements respecting salaries and services were par-

ticularly pertinent to the first motion picture, entitled "Hi Diddle Diddle", subsequently produced by Productions. Three such written agreements, none of which are in evidence, were executed on December 31, 1942, March 10, 1943, and August 6, 1943, respectively. (R. 36-37.) The salaries payable to the taxpayer, Jackson and Stone, respectively, for their services in the production of "Hi Diddle Diddle" were $12,000, $20,000 and $60,000. A substantial part of each of these salaries was deferred pursuant to written agreement. Production of "Hi Diddle Diddle" was commenced in March of 1943 and the film was released in August of that year.

Apparently it was the intention of the stockholders at the time Productions was formed that at least three or four pictures would be produced by the corporation. However, shortly after Productions commenced activity persistent disagreements arose between the taxpayer and Stone which finally culminated in a written agreement between the parties dated September 23, 1943 (Ex. 2, printed in full as an appendix to taxpayer's brief), the material parts are set out in the Tax Court's findings (R. 38-41), which was in the form of a letter addressed to Productions, Stone and Jackson, and signed by the taxpayer, Stone and Jackson individually.

The agreement of September 23, 1943, rescinded and cancelled all other agreements theretofore entered into between the parties, and pursuant to that agreement (Ex. 2, Pet. Br. Appendix A, p. A-4) the taxpayer released or sold to the corporation, Stone

and Jackson, his 20 shares of stock in Productions and also released them—

> from any claims, demands, causes of action, rights or obligations accrued to the date hereof excepting only as expressly hereinabove defined and set forth and you do hereby release and forever discharge me of and from every claim, demand, cause of action, right or obligation accrued to the date hereof excepting only as expressly hereinabove defined and set forth, which you or either of you may have or hold against me.

The considerations enumerated in the agreement of September 23, 1943, in addition to the payment of $9,000 in deferred salary, payable to him out of the proceeds of "Hi Diddle Diddle", were that the taxpayer was to receive certain fixed cash payments from the next three motion pictures to be produced by Andrew Stone for release by United Artists under their existing distribution agreement and to receive directly from United Artists, as distributor of "Hi Diddle Diddle", 20% of the producer's net profits receivable by the producer from the production and/or distribution of "Hi Diddle Diddle", and 12% (later reduced to 10.8% by agreement) of the producer's net profits receivable by producer from the production and/or distribution of each of the next three motion pictures to be produced by Andrew Stone for release by United Artists under their existing distribution agreement. "Producer's net profits" as therein used was defined as any and all sums directly or indirectly accruing or payable to the pro-

ducer from the production and/or distribution of each of such next three motion pictures after deducting certain specified costs and expenses, but limiting the amounts payable to Stone, Jackson, or Productions as services of producer, director, writers, for story, and for screen play. (R. 39-40.)

Under the agreement of September 23, 1943, the taxpayer also agreed to the pledge of his share of the residual values in "Hi Diddle Diddle", on the same basis only as the pledge of all other residual shares, as security for financing necessary to production of the second picture to be produced by Stone; to the pledge of his residual values of the second picture on the same basis for financing necessary to the production of the third picture; and to the pledge of his residual values of the third picture on the same basis for financing necessary to the production of the fourth picture.

Other than his share in the profits of "Hi Diddle Diddle", the taxpayer was not entitled to any further payments under the agreement of September 23, 1943, and he could not compel the others to produce any further pictures.

Some time in 1943 subsequent to the above agreement Productions was dissolved and liquidated and a new corporation was formed by Stone and Jackson, and possibly others, in which the taxpayer had no interest, but which apparently inherited the obligations of Productions under the agreement of September 23, 1943. Stone and Jackson produced the motion picture "Sensations of 1945" under the aegis of this new corporation, and it is the amounts received

by the taxpayer in 1945 from "Sensations of 1945" under this contract that are here in controversy.

It was stipulated below (R. 29) that during the years 1944 and 1945 the taxpayers received $12,500 and $39,862.46, respectively, from the motion picture "Hi Diddle Diddle", and that in 1945 they received the sum of $10,824 from the motion picture "Sensations of 1945". Treating these payments as capital gains, the taxpayer and his wife reported one-half thereof, divided equally between them, in their separate returns for 1944 and 1945. In determining the deficiencies for those years the Commissioner treated these payments as ordinary income taxable under Section 22(a) of the 1939 Code, *supra*. (R. 8-11, 22-25.)

At the trial before the Tax Court it was shown that at the time of the agreement of September 23, 1943, the only asset then owned by Productions, aside from an insubstantial amount of cash, was the film "Hi Diddle Diddle". No other picture had been started, and so far as the record shows, this film, or the proceeds to be realized from it, represented the entire value of the capital stock of Productions at the time the taxpayer purportedly sold his 20 shares to the corporation. In his brief filed in the Tax Court after the hearing the Commissioner, without explanation, conceded that the amounts received by the taxpayer in 1944 and 1945 from the motion picture "Hi Diddle Diddle" constituted capital gain, leaving for determination by the Tax Court only the question whether amounts received from the motion picture "Sensations of 1945" constituted ordinary income or

capital gains. The Tax Court sustained the Commissioner's determination on this issue. (R. 46-47.)

At the hearing before the Tax Court the taxpayer insisted that all sums received by him under the agreement of September 23, 1943, represented payments for the 20 shares of Productions stock which he had sold to the corporation. (R. 110-116, 152-199.) While so insisting, however, his answers on cross examination clearly indicated otherwise. (R. 152-199.) For instance, he explained that one reason for paying him more than what obviously was the value of his stock at the time was because Productions, Stone and Jackson needed his share of the residual value of "Hi Diddle Diddle" to finance subsequent pictures, and that the distribution agreement with United Artists had something to do with it (R. 161, 163-168); that he was protecting his interest in future pictures to be produced by the company, or his right to participate in future income from them (R. 170-172, 186-189).

Counsel now take the position that the agreement of September 23, 1943, being with Stone and Jackson as well as with Productions, sets forth not only the sale of taxpayer's Productions stock, but also the complete divorcement of the taxpayer from the activities of Stone and Jackson; in short, "it represents not only a sale of stock but also a dissolution of a joint venture for the production and distribution of pictures—a joint venture or partnership composed of Stone, Jackson and petitioner" (Br. 11) and that the basic error of the Tax Court "was in failing to see that the consideration paid and promised to

petitioner was for more than merely stock in a corporation which at that time had produced only one picture" (Br. 11).[9] Rather, counsel insist, the consideration "was also for his surrender of a partnership interest in a venture which not only had produced the one picture, but also had a valuable distribution agreement," the services of skilled movie principals, and a projected life of three or four pictures. (Br. 11), and on the basis of these and other assumptions argue that the amount in issue represented capital gain because it represented payments for the sale of a partnership interest or an interest in a joint venture (Br. 10-22).

If the evidence would support this thesis it might be worthy of more consideration. But the evidence does not establish a partnership or joint venture between the taxpayer, Stone and Jackson. That can only be surmised. There were a number of agreements, at least three of which were in writing and which were specifically rescinded and canceled by the agreement of September 23, 1943. Further than that the record shows naught. None of the agreements were put in evidence, and the taxpayer failed to explain their terms or who were parties to them. The only thing definite to be gained from the taxpayer's testimony is that their agreement as to salaries was limited to the one picture, "Hi Diddle Did-

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[9] The Tax Court did not so err. It recognized that the agreement dealt with far more than the mere purchase and sale of stock and that the payments in issue were not for stock, adding that the taxpayer "has not shown respondent to be in error with respect to this issue". (R. 47.)

dle". It can also be gathered from the taxpayer's testimony that at the time Productions was formed the parties planned to produce three or four pictures, but the testimony negates any definite agreement to that effect. Instead, it seems more reasonable to conclude from taxpayer's testimony that each picture to be produced by Productions would be dealt with separately.

The record is equally devoid of any definite evidence concerning a "valuable distribution agreement". The last paragraph of the agreement of September 23, 1943 (Pet. Br. Appendix A, p. A-5), refers to a distribution agreement dated February 2, 1943, "between Andrew Stone Productions, Inc. and United Artists Pictures Corporation", and the payments which the taxpayer was to receive under the agreement of September 23, in addition to the $9,000 of deferred salary and repayment of the $20,000 loan with interest, are limited to the stipulated payments from the next three pictures produced by Stone (Pet. Br. Appendix A, p. A-1) "for release by United Artists under the existing distribution agreement or any extension, renewal, replacement or substitution thereof". The terms of the agreement, the taxpayer's interest in it, or its value to the corporation are not in evidence and cannot even be surmised. In any event, there is nothing to show that the distribution agreement was an asset of any partnership or joint venture of which the taxpayer was a member, and there is nothing in the agreement to show that the taxpayer was selling an interest in the distribution agreement.

We agree with counsel that the agreement of September 23, 1943, shows that taxpayer surrendered more than his stock (Br. 11), but we cannot agree "that this more was a partnership interest" (Br. 11-12). The taxpayer's testimony indicates that his differences with Stone were personal and that the latter was interested primarily in getting the taxpayer out of his hair while the taxpayer was primarily interested in sharing in the profits from future movies produced by Stone. This is essentially what the agreement accomplished. All previous agreements between them to which the taxpayer was a party were rescinded and canceled; the taxpayer surrendered his stock in Productions, thus eliminating himself as an officer and director; the parties mutually released each other from all claims and demands other than as might be bottomed on the agreement of September 23rd; the taxpayer was not to render any services of any nature whatsoever in the future and not to be deemed an agent, partner, representative, associate or affiliate of Stone, Jackson, or Productions, etc., in the production of the next three pictures covered by the contract; the taxpayer continued to commit his residual values in finished pictures to the financing of the next picture; and he was to continue to receive his percentages of the next three pictures produced. The taxpayer's percentage of participation in producer's net profits was fixed at 12% (later reduced to 10.8%) instead of the 20% to which he was entitled before, and by giving up his connection with the corporation the taxpayer removed himself as an officer and director, and also

gave up any right to future salaries, but he was to get certain fixed lump sum payments from future pictures covered by the agreement which may have been intended as partial reimbursement for such lost compensation.

When the agreement is considered as a whole, and particularly in connection with taxpayer's testimony, the amounts received by the taxpayer from "Sensations of 1945" clearly constitute ordinary income. So far as the record shows, they represent a part of the "producer's net profits" payable to him under that agreement, and are in lieu of what he would have received as his share of such profits in the absence of the agreement of September 23, 1943. In any event, we submit, as held by the Tax Court (R. 47) it has not been shown that the Commissioner erred in determining it to be ordinary income. There is no basis in the record for holding that the amount involved represents payment for a capital asset. We find no merit to counsel's repeated assertion (Br. 11, 12, 16, 18) that by the agreement of September 23, 1943, the taxpayer sold a partnership interest as well as his stock in Productions. Not only is there no evidence that a partnership existed, but there is no evidence to support the broad assertion (Br. 18) that such partnership interest included an interest in the good will, facilities and talents of Productions and of Stone and Jackson, including a right to participate not only in the productions and profits of "Hi Diddle Diddle" but also in the production of three or four additional films to be produced by Stone (not Productions) and to share in the proceeds thereof. The

agreement provided for taxpayer's participation in the financing of the next three pictures produced by Stone, and for his sharing in the profits—but only if there were subsequent pictures and if they made a profit—without his participation as an officer, director, or employee of the corporation.

Counsel finally argue (Br. 22-33) that even assuming that the taxpayer has shown only the sale of stock in Productions and not a sale of a partnership interest in addition, the moneys received from the film "Sensations of 1945" constitute a capital gain rather than ordinary income. This final argument is based primarily upon the Tax Court's ultimate finding that (R. 43)—

> The amounts received by petitioner on account of "Sensations of 1945" represent amounts received as consideration for the sale or transfer of his shares of stock in productions. They are not proceeds from the sale or exchange of capital assets, and are taxable as ordinary income.

As we have stated above we are in agreement that the contract of September 23, 1943, covers more than a sale of the taxpayer's stock in Productions, but, as already pointed out, what he parted with in addition is not shown to be an interest in a partnership.

Counsel have rightly called this finding to this Court's attention. It certainly is confusing and contradictory to say the least. We have no explanation for the use of this language if it was deliberately chosen by the Judge who wrote the findings and opinion, because the first sentence is inconsistent with the evidentiary findings relating to this issue (R. 36-

42) and the discussion and holding on this issue in the opinion (R. 46-47). It seems more probable that the words "do not" were inadvertently omitted following "Sensations of 1945" in the final promulgation of this part of the Tax Court's findings and opinion. First, the Tax Court recognized that if the amounts in issue represented a part of the sale price of (or consideration for) taxpayer's stock in Productions they would qualify for treatment as long term capital gain. (R. 46.) The opinion (R. 47) goes on to say, however, that the agreement of September 23, 1943, "dealt with far more" than the mere transfer of title to the taxpayer's shares of stock in Productions. The opinion then enumerates some of the additional matters dealt with in the agreement, including taxpayer's general release of the parties from prior agreements; his agreement permitting the other parties to pledge, where necessary, *inter alia*, amounts due him with respect to "Hi Diddle Diddle" for financing the next motion picture to be produced; taxpayer's rights, in addition to those of a stockholder, to participate in profits from future pictures to be produced, and to be employed in such production; and added that the taxpayer had admitted on brief that factors causing Stone to agree to provisions giving him a share in pictures subsequently to be made included general release and the right to pledge the taxpayer's residual value of "Hi Diddle Diddle". Payments received from a "producer's share of profits" on pictures subsequently made, in consideration for such undertakings by the taxpayer, certainly could not qualify for

capital gain treatment. The Commissioner had already admitted on brief that payments received under this agreement from "Hi Diddle Diddle" were entitled to capital gain treatment, and since the Tax Court was unable to agree with the taxpayer's contention respecting payments received from "Sensations of 1945" it added that "He [taxpayer] has not shown respondent to be in error with respect to this issue." (R. 47.) Again, after adverting to the fact that the taxpayer appeared without the aid of counsel, and was undoubtedly hampered by that circumstance in the presentation of his case, the court added further that (R. 47) "Nonetheless, we are bound by the record as made. On the basis of that record, we cannot hold that respondent erred in treating as ordinary income the amount received in 1945 in respect of 'Sensations of 1945'."

Under all the circumstances it is obvious, we submit, that the Tax Court did not intend the first sentence of its concluding finding, which is inconsistent with the second sentence and also its opinion and decision, to be cast in the form it appears in the record, and we further submit the apparent inconsistency, so obviously inadvertent, does not furnish a basis for reversal of the Tax Court's decision on this issue.

While counsel rely primarily upon this apparent inconsistency in the Tax Court's finding, their argument under this heading (Br. 22-31) contains unwarranted premises or conclusions. First, it treats the Tax Court's conclusion as resting on the belief that the taxpayer's shares of stock could not be given a value greater than a 20% interest in "Hi Diddle

Diddle", adding that it is apparent that the trial court believed that when majority shareholders buy out a minority shareholder, as here, the latter is restricted in the consideration paid him for his stock to an amount equal only to his pro rata interest in a particular tangible asset which the corporation may then have. No such matter was before or passed upon by the Tax Court. The only issue for decision, other than the loss issues, was whether the amounts received from "Sensations of 1945" represented capital gain or ordinary income. Payments received from "Hi Diddle Diddle" were also included in this issue at the time of the trial, and both the trial Judge and counsel for the Commissioner, since taxpayer was not represented by counsel, asked him many questions in an effort to get a clearer idea as to what the payments represented. There is no basis in the record or the opinion, however, for the above premise on which counsel's ensuing argument is pitched. (Br. 22-33.)

The argument then proceeds, primarily on the basis of assumptions not based on evidence, because, as we have stated, no such issue was before the Tax Court, to attempt to demonstrate that taxpayer's stock had a value in excess of the 20% interest in "Hi Diddle Diddle", with the alleged result that the payments here involved were consideration for the taxpayer's stock. The evidence does not support this part of the taxpayer's argument.

To sum up the issue here involved, as stated several times above, is whether the payments received from "Sensations of 1945" by the taxpayer in 1945,

pursuant to the agreement of September 23, 1945, represent capital gain or ordinary income, the taxpayer originally contending but failing to convince the Tax Court, that they were part of the consideration for his Productions stock. Taxpayer is now contending, mainly, but without any evidentiary support, that payments received by the taxpayer were consideration for the sale of a partnership interest as well as his Productions stock. We submit, however, that there is not sufficient evidence to warrant a finding that the amounts in issue were received as consideration for the sale of any kind of a capital asset, and the Tax Court correctly found (R. 43) that "They are not proceeds from the sale or exchange of capital assets, and are taxable as ordinary income".

CONCLUSION

The decisions of the Tax Court are correct. They are supported by the facts and the law and should be affirmed.

Respectfully submitted,

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